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CROSS-BORDER INSOLVENCY

Report on UNCITRAL - INSOL Judicial Colloquium on Cross-Border Insolvency

Note by the Secretariat

INTRODUCTION

1. The present note contains a description of the information presented and conclusions drawn at a Judicial Colloquium on Cross-Border Insolvency, held on 22 and 23 March 1995 at Toronto by the Secretariat of the United Nations Commission on International Trade Law and the International Association of Insolvency Practitioners (INSOL). The purpose of the Colloquium was to obtain for the Commission the views of judges, and of Government officials concerned with insolvency legislation, on judicial cooperation in cross-border insolvency cases (hereinafter referred to as "judicial cooperation"), and the related topics of court access for foreign insolvency administrators and recognition of foreign insolvency proceedings (hereinafter referred to as "access and recognition"). The Colloquium was designed to assist the Commission as it embarks on work on those aspects of cross-border insolvency.

2. Over 60 judges and Government officials from thirty-six States took part, representing a broad range of practical experience and the perspectives of diverse legal systems. It provided an opportunity to obtain at a formative stage of the Commission's work the views of those who would be the end-users of a legal instrument devised by the Commission to deal with cross-border insolvency. The Colloquium also provided a unique opportunity for judges to have contact with each other and further their understanding of the various national approaches to dealing with cross-border insolvency cases, a type of contact that has value in itself in furthering judicial cooperation.

3. In connection with its decision to undertake work on those aspects of cross-border insolvency, the Commission had decided at its twenty-seventh session to hold the Colloquium. That decision in turn was taken in the light of views expressed at a first UNCITRAL-INSOL Colloquium (Vienna, 17-19 April 1994), which involved insolvency practitioners from various disciplines, judges, government officials and representatives of other interested sectors including lenders. That Colloquium reported on difficulties currently arising in cases of cross-border insolvency, and the resulting undesirable economic and other effects, both as to asset value available for creditors and the feasibility of saving businesses and employment. It was recommended that the Commission

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could make a useful contribution in a relatively short time with a project specifically designed to facilitate judicial cooperation and access and recognition. It was further suggested that a hearing of the views of judges would be a useful first step, not only in further assessing the desirability and feasibility of such work, but also in gathering the information necessary to initiate work.[1]

UNCITRAL--INSOL JUDICIAL COLLOQUIUM ON CROSS-BORDER INSOLVENCY

A. Background report of expert group

4. The participants at the Judicial Colloquium were aided in their discussion by a background paper on cross-border insolvency prepared by a group of experts assembled by INSOL. That paper will be finalized taking into account the views expressed at the Judicial Colloquium and will be of use in the Commission's work on cross-border insolvency.

5. The paper summarized the current legal environment in which solutions to cases of cross-border insolvency must be crafted. That environment was characterized by diversity and often inconsistency in legal approaches applied in cross-border insolvency, including the degree of discretion that might be available to judges in the absence of statutory authorization. This situation may jeopardize in any given case the possibility of implementing a liquidation or reorganization plan that maximizes the value of the debtor's assets and saves as much employment as is possible. For example, some States adhere to a "territoriality" principle which may deny recognition to foreign insolvency proceedings and assert control over domestic assets, while States in a bilateral or multilateral treaty arrangement might be bound to apply approaches aiming at a single or common administration of the insolvency (e.g., Montevideo Treaties of 1889 and 1940; Nordic Bankruptcy Convention), or at harmonization among any concurrent proceedings.

6. The report described the legislation found in a limited number of States specifically dealing with judicial cooperation, access and recognition in the insolvency context. Typical characteristics or effects of such statutes include: the possibility for a foreign insolvency representative to open secondary or "ancillary" proceedings; the power of the court to stay at the behest of the foreign representative commencement or continuation of actions against the debtor or the debtor's property or to enforce a judgement against the debtor; and the turnover of property of the estate or proceeds of such property to the foreign representative.

7. Such legislation varies in the extent to which cooperation and assistance are mandatory or subject to the discretion of the requested court, as regards both the questions of access and recognition and the degree of cooperation to be given. For example, in one country there is a two-tiered approach, in which recognition and assistance are mandatory for proceedings from certain prescribed countries, based on an assessment as to the nature of the proceedings carried out in those other countries or perhaps other aspects of compatibility of legal systems. For other countries the approach is one of discretion.

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[1] The Commission's current work on cross-border insolvency dates back to a proposal made at the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century", which the Commission decided at its twenty-sixth session to pursue further. The previous deliberations and decisions of the Commission leading up to its current work on cross-border insolvency are reported in A/48/17, paras. 302-306 (twenty-sixth session) and in A/49/17, paras. 215 to 222 (twenty-seventh session). The papers presented to the Commission for its deliberations included A/CN.9/378/Add.4, and A/CN.9/398 (report on UNCITRAL-INSOL Colloquium, Vienna, 17-19 April 1994).

8. Another approach is to authorize cooperation and assistance across the board to all countries, but to leave the actual extent of cooperation and assistance afforded in any given case to the discretion of the court, with the possibility of including in the statute factors to guide exercise of discretion. Those factors include, for example, the just treatment of all creditors, and substantial consistency between legal systems involved as to the distribution of proceeds.

9. Yet another variant mandates assistance to proceedings from prescribed countries, as certified by State officials; the exercise of discretion as to the type of cooperation in individual cases is to be guided in particular by the rules of private international law.

10. Also described were various techniques and notions employed in pursuit of judicial cooperation and access and recognition in particular in the absence of a specific legislative or treaty framework. Those techniques include: application of the doctrine of comity by courts in common law jurisdictions; issuance for equivalent purposes of enabling orders (exequatur) in civil law jurisdictions; conclusion of ad hoc protocols to establish cooperation among jurisdictions involved in a cross-border insolvency case and to facilitate cross-border administration of an insolvency; enforcement of foreign insolvency orders by way of general legislation on recognition of foreign judgments and procedures such as letters of request (letters rogatory) from foreign jurisdictions. Annexures were included in the report containing more detailed descriptions and comparisons of approaches taken in various countries to judicial cooperation and access and recognition.

11. The report made a number of tentative conclusions and recommendations, including: (i) that States should be encouraged to enact in their legislation some basic rules to apply in cases of cross-border insolvency; (ii) recognition should normally follow expeditiously from establishing the basic elements of: the commencement of a valid insolvency proceeding, the control of the business affairs and assets of the debtor, the presence in the foreign jurisdiction of business interests or assets of the debtor or of persons or information relating to the business affairs and assets of the debtor; (iii) the rules on recognition and its consequent effect should foster predictability; (iv) applications for recognition and enforcement should be through judicial processes; (v) an applicant for recognition should not be deemed to have submitted fully to the jurisdiction of the foreign country when appearing in connection with the insolvency; (vi) upon recognition, such cooperation and assistance should be available as is not inconsistent with the law of the foreign country, with the relevant court being given the discretion to provide such aid and assistance as may be appropriate in the circumstances.

B. Judicial Colloquium programme

12. The first portion of the Colloquium was devoted to presentations on six major cases of cross-border insolvency by individuals involved in the cases. The presentations were made by presiding judges from various countries and differing legal systems that presided over proceedings in some of those cases, as well as by insolvency administrators and other court-appointed insolvency officials. That was followed by a presentation of the report, observations of leading academics in the field of insolvency law, and a closing evaluation by a multinational panel of judges. In addition, interspersed in the programme were several open floor segments, which substantially added to the range of experiences and views presented.

13. Views and issues raised at the Colloquium are summarized below, by reference to the principal elements of the work being undertaken by the Commission: judicial cooperation, as well as access and recognition.

1. Judicial cooperation

14. The experiences and views reported at the Colloquium reflected the general willingness and interest of judges to cooperate in cases of cross-border insolvencies. At the same time, judicial cooperation was hindered by disparity or inadequacy of laws regarding judicial cooperation. It was generally felt that a text from UNCITRAL, for example in the form of model legislative provisions, could usefully support extensions of cooperation and assistance by judges from legal systems where such judicial activity would require a statutory authority. Moreover, even in jurisdictions where judges were given broad discretionary power, it had been shown that a legislative framework could provide added predictability as regards resolution of cross-border insolvencies.

15. There was support for exclusion of consumer insolvencies from the scope of the instrument to be prepared by the Commission. It was not intended, however, to limit thereby the scope exclusively to insolvency of legal persons, since there could be cases of individuals conducting economic enterprises of a commercial nature, without the formal garb of a corporate entity. There was less agreement as to whether the legal text to be prepared by the Commission should venture into attempts to harmonize notions such as "claim", "future claimants", and "discharge". A concern was that such attempts might go beyond what was needed to facilitate judicial cooperation and access and recognition, and adversely affect the feasibility and acceptability of the text.

16. Views were expressed in favour of including in cooperation legislation some version of an automatic stay of execution of claims. This would provide at least a minimum period of time to examine the request of the foreign insolvency representative before a liquidation or dismemberment of the insolvent estate. Favourable views were expressed regarding the potential benefits of a judge appointing a neutral third party, for example, to help harmonize concurrent proceedings, to facilitate agreement, mediate disputes and limit polarization among the various parties, and to resolve impediments to reorganization plans.

17. It was reported that communications between judges in cross-border insolvency cases could be particularly useful for clarifying conflicting information, keeping track of foreign proceedings, obtaining explanations of foreign law, and developing insolvency plans and solutions agreeable to parties in both jurisdictions. Various perspectives were presented as to such communications, some favouring a relatively unbridled right of judges to communicate directly, and others favouring varying degrees of restriction and procedure. The suggested restrictions on judicial communications sprang from concerns as to the propriety and fairness of conducting such communications in the absence of the parties. Possible procedural requirements mentioned included a record of the communication, notice to the parties of the communication, or an opportunity for the parties to be present.

18. A suggestion not directly related to the work of UNCITRAL, but one intended to facilitate judicial cooperation, was the establishment of a method of accreditation of insolvency representatives, so as to increase the confidence of judges requested to act by foreign insolvency representatives.

2. Access and recognition

19. A consensus supported the inclusion in the text to be prepared by UNCITRAL of provisions on access and recognition. As to the type of proceedings to be recognized, a view was expressed that the provisions should be limited to proceedings in which the debtor was actually insolvent. The suggestion not to cover voluntary insolvency proceedings and proceedings in which the debtor was left in possession of the assets during the insolvency proceedings, or could be seen as "trading while

insolvent", sought to take into account that such cases were either not recognized universally or were treated differently by States.

20. It was noted that the background paper had proposed a way that might overcome such differences among legal systems, by focusing on the nature of the proceeding rather than on whether the debtor was insolvent. The essential elements of a covered proceeding would include: commencement pursuant to insolvency law; the aim of collective communal benefit of creditors; and effective external control of the management of the business interests and assets of the debtor by an administrator (whether such administrator was an independent administrator or the debtor itself).

21. Other issues suggested for attention in legislative provisions on access and recognition included: providing some enforcement effect to recognition of foreign proceedings; providing for limited appearances by foreign insolvency representatives, that would not submit them to the full jurisdiction of the court; granting equal access to creditors and doing away with automatic priority of local creditors; providing a rule on allocation of primary proceedings, with the effect that all other proceedings would be secondary or ancillary. It was noted that the question of which of these issues to address would be considered bearing in mind the advantages as regards both feasibility and acceptability of developing an instrument that was not overly extensive as to the issues that it attempted to deal with.

CONCLUSIONS

22. The Judicial Colloquium reflected a consensus view that the development by UNCITRAL of a legislative text of limited scope (e.g., in the form of model statutory provisions facilitating judicial cooperation and access and recognition) was both desirable and feasible. The urgency of giving attention to this matter was emphasized in view of the increasing incidence of cross-border insolvency.

23. The Commission may wish at this stage to assign a working group to consider in detail the views and information presented at the Judicial Colloquium. Two working group sessions might be scheduled prior to the twenty-ninth session, taking advantage of the availability of the information gathered in the expert group report and elicited at the colloquia that have been held.

24. The working group could also consider proposals made as to the possible form and content of the Commission's work (e.g., model legislative provisions containing a "menu of options" for legislators, possibly inspired by alternative approaches followed in existing legislation on judicial cooperation and access and recognition; see paras. 6 to 9).

25. Such a method would present to States various possible approaches that they may wish to adopt with respect to the two basic questions of: access and recognition of a foreign insolvency representative, on the one hand, and, on the other, the determination of the degree of cooperation to be extended in any given case. On the question of access, one approach, for example, would be to have mandatory access with respect to proceedings from prescribed countries, based on an assessment of factors such as compatibility of legal systems, with discretionary access as regards proceedings from other countries. Another approach would be discretionary with respect to all countries. An additional layer of options presented to States would concern the scope of the types of measures possibly to be granted in support of foreign proceedings, and the conditions to be met to obtain those measures.

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POSSIBLE FUTURE WORK

Build-Operate-Transfer Projects

Note by the Secretariat

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INTRODUCTION

1. At the Congress on International Trade Law held in May 1992 in New York in the context of the twenty-fifth session of the Commission, it was proposed that the Commission consider undertaking work in the field of the "build, operate and transfer" (hereinafter referred to as "BOT") project financing concept. Subsequently, at its twenty-sixth session, the Commission had before it a note on possible future work (A/CN.9/378), in which the Secretariat informed the Commission that it was monitoring the work by the United Nations Industrial Development Organization (UNIDO) on the preparation of "Guidelines for the Development, Negotiating and Contracting of BOT Projects". At the Commission's twenty-seventh session, the Secretariat presented a note apprising the Commission on the progress of work on the UNIDO Guidelines (A/CN.9/399) and suggesting possible areas in which the Commission could consider taking up future work. The Commission emphasized the relevance of BOT and requested the Secretariat to present a note to the Commission at its twenty-eighth session on possible future work on BOT projects.

2. Preparation of the Guidelines by UNIDO is now at an advanced stage. It is expected that the final text of the Guidelines will be issued by April 1995. The UNCITRAL secretariat has closely followed the work done on the Guidelines, in particular those aspects that relate to possible future work by the Commission. The Guidelines are geared towards describing the main policy concerns that States should address when deciding whether or how to implement BOT projects. They begin with a chapter introducing the BOT concept, which also discusses the various considerations that a government should bear in mind before deciding to carry out a project by way of BOT; the following chapters deal with the main issues that arise with regard to BOT projects such as the role of government, financial analysis, operation and maintenance, and the transfer of ownership. Since the Guidelines cover the subject of BOT in its entirety, they do not deal in extensive detail with the issues discussed in this note. (see also below, para. 51.)

I. THE BUILD-OPERATE-TRANSFER CONCEPT

3. In its most basic form, BOT is a form of project financing where a government grants a concession for a period of time to a private consortium (hereafter referred to as the "project company") for the development of a project; the project company then builds, operates and manages the project for a number of years, recoups the construction costs and derives its profit from the proceeds generated by the operation and commercial exploitation of the project. At the end of the concession period, the project is transferred to the government. Although the generic term used for this type of project is "build-operate-transfer", other terms used to describe this form of project financing include "build-own-operate-transfer" (BOOT), "build-own-lease-transfer" (BOLT) and "build-rent-transfer" (BRT). Although these different terms denote the variations in which some of the projects are structured, they all contain the basic elements of a scheme by which a government grants concessions for projects to be implemented and operated through private sector financing.

4. In this arrangement, the repayment of any loans borrowed to implement the project is generally not guaranteed by the government of the host country, but depends on the revenue generated by the project. Unlike the traditional project financing structure in which the owner (the government) guarantees the repayment of borrowed funds, in BOT the project company arranges

for guarantees to the lenders of the project covering repayment of the borrowed funds. The loans are made against the project's anticipated cash flow. This provides a number of benefits to the host government. Among these benefits is that, since direct funds from the public budget are not required, the government will experience reduced pressure of public borrowing. Private sector financing also generally allows for the transfer of the financial, industrial and other risks to the private sector. Furthermore, since the project is built and, during the concession period, operated by the project company, the government gains the benefit of private sector expertise in operating and managing such projects.

5. Traditionally, contracts for the construction of infrastructure or other works stipulate that the owner takes over the facility when its construction is completed in accordance with the construction contract. The financing is arranged by the owner who pays the contractors, either by drawing money from a loan or from its own resources. In such contracts, the basic duty of the contractor is to build and to equip the contracted facility, while the economic viability and profitability of the project are the concern of the owner. In a BOT project, however, the project company has not only to organize the financing but also to ensure that the project will be profitable. The project company therefore has an interest in the feasibility and design of the facility and in ensuring that the legal and commercial conditions necessary to construct and operate the facility in a profitable manner are in place and will remain basically unchanged during the period of the concession.

6. Two of the factors that may lead to lengthy and often complicated negotiations are the financing and contractual arrangements. With regard to financing, the main problems arise because, with the lack of sovereign guarantees, the project company and the lenders have to find the means by which to cover the attendant risks including by way of insurance and various other forms of guarantees. The risk distribution schemes in BOT can therefore be quite complex.

7. In the area of contracting, some of the problems arise due to the fact that a BOT project normally involves a high number of contractually interrelated parties. Beside the host government and the project company, other parties usually include the lenders, the construction company and the equipment suppliers, independent investors of capital and the purchasers or end users of the project's product. In most instances, the project company will itself be a consortium of construction companies, engineering equipment suppliers and other private investors, and the operator of the project. There may also be involvement by way of capital contributions by institutional investors and multilateral development agencies.

8. Because of the various novel aspects necessary for the successful realization of a BOT project, an important ingredient is the support of the host government. The host government not only has to authorize the project but will be the ultimate owner of the facility. The government has to oversee the implementation of the concession agreement and may, in some instances, be a participant in some of the debt or the equity. In order to ensure long term private sector participation, the government has to ensure a stable political base and a legal climate that is conducive to long term private investment. This will range from the establishment of a legal framework for private investments to putting in place the necessary administrative machinery for the timely, fair and objective issuance of any required approvals, permits or licenses.

9. Due to a number of factors, including the benefits mentioned above (para. 4), there has been a substantial increase in many States in the number of BOT projects being implemented. Chief among the factors that have led to the interest in BOT projects is the potential for mobilization of private sector resources for infrastructure development without the necessity to raise the public debt. This is particularly so at a time when there is an increase worldwide in privatization of various sectors previously reserved for the public sector, coupled with decreasing availability of public sector funds for infrastructure development. The other advantages include increased involvement of the private sector in the management of public infrastructure, increased potential for direct foreign investments and the opportunity for governments to use the BOT facilities as a benchmark for the performance of similar projects in the public sector.

10. Many of the BOT projects that have so far been implemented have been large infrastructure projects, in particular in the areas of power generation and transport (toll roads, bridges and railways). However, as the potential for BOT is more widely realized, smaller and medium sized projects such as water treatment schemes, hotels and medical facilities are being proposed for implementation by way of BOT.

II. LEGAL PROBLEMS IN IMPLEMENTATION OF BOT PROJECTS

11. Despite the advantages mentioned above and the potential that exists for BOT projects, various legal and practical obstacles can make it difficult to implement such projects. Legal obstacles may arise because of the lack of a proper legal and regulatory framework to attract long-term private-sector involvement in such projects. Since the private investors and financiers carry most of the risk for the performance of the project, they have a keen interest in the existence of a legal infrastructure that enables a fair return on their investment and the enforceability of the contractual obligations entered into by the various parties.

12. Additional obstacles may arise, for example, in the area of procurement. Unlike the normal practice in procurement for traditional projects, where the government solicits tenders on the basis of a well defined project within predetermined specifications, in BOT the call for tenders may precede any design work. To the extent that there may be a lack of clear guidelines on the basis of which to evaluate tenders or proposals that will in all likelihood contain varied solutions to a set of problems, a lengthy and therefore costly bidding process may ensue, one that runs the risk of compromising the integrity of the procurement process. The government also has to define clearly how to deal with unsolicited proposals since, in many instances, the private sector is encouraged to take the initiative in project identification.

13. Yet another obstacle to implementation of BOT projects is the limited experience, in particular on the government side, on negotiating simultaneously with a multiplicity of parties, many of whom will be contractually interrelated. Although most of the contracts entered into to implement BOT projects might not, in themselves, present any novel issues, the BOT context presents some problems in that all the various contracts have to fit into a composite contractual package.

A. Inadequacies in the legal framework

14. As noted earlier (para. 10), the BOT concept has so far mainly been used in the implementation of large infrastructure projects, which involve the expenditure of substantial amounts of money by private investors. The predominant proportion of the funds used to implement such projects is generally obtained by borrowing from commercial banks and other financial institutions. However, the repayment of borrowed funds and the return for the equity investors take place over an extended period of time. The lenders to the project and the equity investors will therefore look for a clear manifestation by the host government of its intention to encourage long-term private investments and that such investments will be protected from expropriation or nationalization without fair compensation.

15. One of the means by which the host governments can manifest such intention is by providing a sound legal framework that encourages private investment and ensures recovery of the returns on the investment. Most of this will be in the form of legislation that governs investments and other commercial matters in general and that is not necessarily geared towards BOT projects specifically. The existence of such general legislation not only provides confidence to the private investors willing to engage in a BOT project but also makes the negotiation process for specific projects easier. This is because, in the absence of such legislation, parties to a BOT contract will normally insist that certain issues and guarantees that would otherwise be covered by legislation be negotiated and provided for in various contracts, which may make the negotiating process more involved.

16. Such general legislation that is relevant to one degree or another to BOT projects falls into two categories. The first category includes legislation primarily geared towards promotion of foreign private investment. The terms of such legislation that will be of particular interest to sponsors of BOT projects and to their lenders will include provisions on private ownership of land and other assets, on repatriation of profits and on foreign exchange convertibility. The second category includes the general commercial legislation of the host country, in particular, legislation on incorporation or formation of commercial enterprises, legislation on securities arrangements as well as a liberal framework governing commercial contracts and dispute settlement procedures. The existence of such legislation provides the participants in the BOT project with a solid legal basis for their investment and therefore contributes to the reduction of the risk of the investment, thus decreasing the cost of the project.

17. In some of the areas of law just mentioned, harmonized legal texts exist which States would be advised to consider for adoption, including texts prepared by the Commission. Those texts include the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Commercial Arbitration, the UNCITRAL Model Law on International Credit Transfers and the UNCITRAL Model Law on Procurement of Goods, Construction and Services.

18. Beyond the need for such general legislation, there is a need, in many instances, to provide legislation for the implementation of certain aspects of BOT projects. Legislation geared specifically towards implementation of BOT projects not only provides clear signals to potential investors of the interest of government in carrying out such projects but also provides and facilitates private sector participation in public sector projects. For example, in most States, public infrastructure has traditionally been financed and run, to a large degree, by public sector

institutions usually operating as monopolies. In most such instances, there might be a need to provide a legislative basis for private sector participation and, in particular, the right to charge the public for the use of the facility to be built or for its product. In some States, there might be a need to provide for the regulatory framework for such concessions.

19. Legislative approaches differ among those States that have enacted legislation for BOT projects. In some States, BOT legislation only regulates the implementation of such projects in a particular sector, for example, power generation. Typically, such legislation will include provisions on: which aspects of the regulated sector can be implemented by way of BOT; the extent of governmental involvement, including what may be granted by the government to the project company (e. g., land rights); issuance of approvals; and authorization for profit recovery, possibly including detailed calculations on the rates and charges that may be levied by the project company for the sale of the end product of the project. Such legislation sometimes also includes special provisions on how procurement for the projects is to be carried out.

20. Other States have adopted legislation aimed at regulating the implementation of BOT projects generally. Such legislation is normally not as detailed as the legislation aimed at a specific sector and differs from State to State. There are, however, two main approaches to such legislation. In one approach, the legislation only sets general parameters within which government agencies can negotiate BOT contracts. This has the advantage of providing flexibility to negotiate the contracts in a manner that suits the particular circumstances of each project. Typical provisions of such legislation include, for example: the authorization to grant concessions to the private sector for BOT projects; an indication of those sectors in which BOT projects may be carried out; and general rules on how financing may be raised and on incentives that may be granted to entities that wish to carry out BOT projects, including various forms of tax relief. Provisions on procurement, including on methods of solicitation and evaluation of tenders or proposals, are sometimes also included in such legislation.

21. Another legislative approach to regulating BOT projects generally is to establish fairly comprehensive provisions on how a BOT project may be implemented, with the parties having to negotiate only the detailed terms and conditions for each project. Typically, such legislation will include provisions that define the basic content of contractual obligations for the implementation of a project, including provisions on such matters as the maximum period of time for which concessions may be granted, extent of possible government support, detailed procurement rules, the means of debt repayment and repatriation of profits, and conditions for the operation and transfer of the project.

22. The divergences in legislative approaches and in the scope of the legislation may indicate that, generally, legislative efforts have been primarily aimed at dealing with problems as they arise as opposed to a comprehensive approach aimed at dealing with all the issues that need legislative action for the proper implementation of BOT projects. This is particularly so with regard to legislation aimed at regulating BOT projects only for a particular sector. Although legislation might be easier to implement for a sector in which BOT projects are foreseen or planned and the problems are clearly definable, this also means that further legislation would have to be considered if BOT projects come up in other sectors. To that extent, it might be preferable to enact general enabling legislation on BOT and, in those instances when certain peculiar aspects of one sector may demand legislation to implement BOT in that sector, then such particular circumstances may be addressed by way of regulations.

23. In legislation aimed at regulating BOT projects generally, it might be preferable to consider dealing with as many of the issues as arise in the implementation of such projects as can be dealt with legislatively. This is of particular importance in those instances where the underlying legal infrastructure does not deal with such issues in a comprehensive manner. Such an approach would have the benefit of providing the parties with the general parameters within which to negotiate the contractual details of each project. This, however, has to be balanced with the need to provide those negotiating the contracts with some flexibility so as to enable them take into account particular circumstances that may arise in specific projects.

B. Procurement aspects

24. The expenditures involved in the procurement of goods, construction and services for large infrastructure facilities can be quite large. Furthermore, most of the projects tend to be fairly complex technically and in the financing arrangements. Therefore, the means by which procurement is carried out is of vital importance in ensuring that the project turns out to be economically viable, of good quality, and that it is completed at a reasonable cost. However, because of a number of factors peculiar to BOT projects, the risk that procurement may be carried out in a less than efficient manner is increased and may jeopardize successful implementation of the projects.

25. Because of the size of most projects, preparing bids for BOT projects can be difficult and costly. Most of the potential project sponsors will therefore prefer not to be involved in a procurement process unless they are confident that the process is fair and transparent. At the same time, in proportion to the significance of the project, the government normally wants to ensure that it gets the most economically viable project, at the best possible terms, objectives which are more likely to be achieved by engaging in an open, fair and competitive procurement process conducive to potential sponsors offering their best terms.

26. In typical construction project procurement, the government normally identifies the project, calls for tenders on the basis of fairly well defined specifications, and evaluates the tenders on the basis of established and pre-disclosed criteria. However, in BOT projects, the government will normally want to maximize private sector innovation in project design and management and will therefore, in many instances, not be in a position to draw up a single set of specifications which would form a common basis for the evaluation of the tenders or proposals. Additionally, even in those instances where it is possible to define the parameters of the project, potential bidders might offer technical solutions alternative to those envisaged by the government. Furthermore, since the project company arranges the financing, it will also have an interest in a cost efficient project and will therefore want to have an input in the design of the project. It may therefore be difficult to engage in open competitive tendering on the basis of similar and pre-defined specifications.

27. Governments may therefore view negotiations with contractors as an alternative to competitive tendering and as the means to obtain the best terms. However, the government is not always in a position to prepare proper guidelines on which to base such negotiations. This may give rise to lengthy negotiations, sometimes involving multiple contractors at the same time, thus increasing the possibility of abuse and loss of integrity in the procurement process. It is therefore important for the government to establish clear and transparent guidelines for procurement based on as competitive, transparent and objective means of procurement and to avoid unstructured

negotiations. The procuring entity also should have a clear system by which to compare and evaluate tenders or proposals whose design and technical specifications can be fairly different.

28. A further complicating factor in the procurement process is that it is not always clear to what extent the cost of the project should be a criterion by which governments evaluate bids since the government does not provide the financing. To some extent, the financiers and operators of the project have a stronger interest in reasonable costs for the project. But as the ultimate owner of the project, and since the cost of the project has an impact on the rates or tariffs charged to the end users for the product of the project, the government will want to ensure that the project is well designed and that the costs are reasonable. This, coupled with the fact that the procuring entity may not be able to draw up a single set of specifications, usually means that some form of negotiations are held as part of the procurement process.

29. The other area in which procurement for BOT projects differs substantially from typical construction project procurement is in the financing component. Proper structuring of the financial package is normally the most difficult, and usually the most important, aspect of a BOT project. Potential lenders to a project will need to be assured of a secure source of revenue to cover the debt and operating costs of the project and to provide a fair return to the equity investors. Beyond the terms aimed at ensuring the economic viability of the project, the security mechanisms aimed at covering and distributing the various pertinent risks are part of the financial package.

30. Notwithstanding that putting together the financing is the obligation of the project company, the government will have an interest in ensuring an attractive financial package as this impacts on the overall economic viability of the project. In most instances, therefore, the government will aim to make the attractiveness of the financial package part of the evaluation criteria. However, from a procurement perspective, it is sometimes not clear of what importance, as a criterion for evaluation, the structure of the financial package is to the government, since the government does not provide any sovereign guarantee for the repayment of the loans. Furthermore, because of the frequent changes in the terms and conditions in the financial markets, most lenders are unable to commit to specific financing terms over a long period of time without a binding contract. Yet, as the eventual owner of the project, the government has to protect its interests by ensuring the long-term financial viability of the project.

31. As to the operational phase of the project, in most instances the operator of the facility will be part of the project company. In some instances, however, the project company may enter into an operating contract with an independent operator. From a procurement perspective, this should not necessarily present any problems to the government. This is because the interest of government lies in ensuring that the terms of the operational phase, for example, as to transfer of technology and maintenance, are as beneficial to it as possible, which terms are capable of being clearly defined and quantified in advance and made part of the evaluation criteria. However, attempting to ensure the most beneficial terms usually leads to negotiations on the terms of the operational phase which not only makes the procurement process lengthy but may also lead to abuse.

32. Yet another problem that arises with regard to procurement for BOT is that of unsolicited proposals. Unlike the practice with typical construction projects where the government identifies and sets the parameters for the projects, the practice in the context of BOT is generally to

encourage the private sector to propose possible projects. This is of advantage to the government in that it encourages private sector innovation and financing in areas in which the government might not be able to undertake work on the strength of its own resources. The possibility of making unsolicited proposals is of advantage also to the private sector which does not then have to always wait for the government to formulate possible projects. However, from a procurement perspective, unsolicited proposals deny the government the benefits that accrue from competition in procurement, since the main incentive for those who make the proposals is that they will be awarded the project. Governments are therefore faced with the dilemma of how to offer adequate incentives so as to encourage unsolicited proposals, while at the same time building an adequate degree of competitive procurement into the process.

33. One means of dealing with many of the problems that arise with regard to procurement for BOT is to have in place modern procurement legislation which promotes the objectives of competition, fairness and integrity while maximizing economy and efficiency in the procurement process. The UNCITRAL Model Law on Procurement of Goods, Construction and Services provides an internationally accepted model for such modern procurement legislation. The Model Law sets forth the procedures for a number of procurement methods which equip the procuring entities with the ability to select suppliers and contractors in a variety of circumstances and in order to meet various types of procurement needs. Some of these procurement methods and procedures may have specific application in the BOT context. For example, two-stage tendering and request for proposals are methods that allow for solicitation of differing tenders or proposals.

34. In two-stage tendering, the procuring entity, during the first stage, invites tenders only for the purpose of developing the technical and quality specifications of a particular project. Under this method, the procuring entity may then hold negotiations with the contractors who have submitted tenders with the aim of arriving at a single set of specifications. In the second stage, the procuring entity then invites tenders on the basis of the single set of specifications that result from the first stage. The other method in the Model Law suitable for BOT procurement is request for proposals, which also provides a vehicle for the solicitation of various technical proposals, while providing a structure for objective comparison and evaluation. Under this method, the procuring entity invites proposals on how to best meet its needs and holds negotiations with the contractors who have submitted proposals after which negotiations they may then submit their best and final offers. The procuring entity then evaluates the proposals on the basis of pre-disclosed criteria, and awards a contract to the proponent of the proposal that best meets the needs of the procuring entity.

35. However, in order to deal with some of the problems that are peculiar to procurement for BOT, governments would benefit from guidance on how to conduct procurement for BOT in a manner that promotes competitiveness, fairness and integrity in the process. Such guidance would take into account some of the peculiar aspects of BOT projects such as the difficulty that the procuring entity may encounter in establishing a common basis on which to compare certain aspects of the tenders or proposals, while at the same time encouraging private sector innovations. Some practical solutions on how to avoid unstructured negotiations with multiple parties, which is the problem that may lead to abuse and to loss of confidence by the contractors in the procurement process, would be particularly useful. With regard to unsolicited proposals, it would be useful to provide some guidance on possible ways of balancing the advantages provided by private sector project proposals with the advantages of competitive procurement.

C. Complexity in contracting

36. BOT projects differ substantially from traditional construction projects also with regard to the contractual arrangements. In regular construction projects involving a government, the main party to the contracts for implementing the project from the standpoint of the host country is the government. The financing contracts with the lenders and the construction contract with a contractor are the principal contracts. Normally, therefore, the main parties to the contracts implementing such a project are the government, the lenders and the contractor. In most instances, any financing arrangements that the government has to enter into are legally separate from the construction contract which terminates upon completion of the project. The repayment of financing could take place over a long period, but usually would not depend on whether the facility is eventually profitable.

37. The main characteristic of BOT projects in contrast to traditional construction contracting is the large number of parties involved in the implementation of the project with many of these parties being contractually interrelated. Furthermore, most of these contractual relationships extend over a long period of time. The principal contracts in a typical BOT project include the project agreement, the joint venture or consortium agreement, the construction contract, the equipment-supply contract, the operation and maintenance contract and the contracts that form the financial package, including the insurance contracts and other security arrangements. Negotiations to put together the contractual package can therefore be complicated and time consuming, thus increasing the cost of the project and the risk of its failure.

38. Although the precise contractual arrangements differ from project to project, the central contract in a BOT project is the concession or project agreement between the government and the project company. In this agreement are set out the main terms of the concession, such as the length of the concession period, the amount and method of payment for the project end product, any performance conditions, the extent of the monopoly granted to the project company, and the terms and conditions for the operation and maintenance of the facility, and of its transfer to the government at the end of the concession period. Where the underlying legal infrastructure might not adequately address certain issues, for example, repatriation of profits or certain tax incentives, these may be dealt with in the project agreement. Although the agreement is between the government and the project company, some of the other parties involved in the project will have an interest in the terms of the contract. For example, the financiers and the operating company will be interested in the length and the exact terms of the concession period, both of which will impact on the loan repayments and on the terms regarding the operational period.

39. The fact that the financiers have no recourse to the government in case of the projects' failure (non-recourse financing) gives rise to certain factors which usually complicate the negotiations of the contracts that form part of the financial package. Non-recourse financing imposes greater risk on the financiers and the project company than is the case in traditional construction projects. Most of the difficult factors are therefore related, in varying degrees, to the question of how to allocate various risks amongst the parties. One of the principal factors is that the lenders will require commitments from the project company and also from the government that the project will be financially viable over the long term in order to ensure repayment of borrowed funds.

40. Depending on the type of project, these commitments can be arranged in a number of ways.

For example, revenues from tolls for roads and bridges may be assured by the government committing itself to a minimum level of traffic below which the project company would be released from certain commitments. This may involve, for example, the possibility of extending the life of the concession or the provision of some form of re-financing to offset any revenue shortfalls that might otherwise adversely affect the servicing of the debts. In the case of BOT power plants, adequate revenue source is normally assured by means of a long term contract with a government-owned utility to purchase the power. Thus, although such types of contracts may be separate from the financing contracts between the lenders and the project company, they are a crucial element in successfully putting together the financial package and the lenders and equity investors will therefore have an interest in what these contracts provide.

41. The other means by which lenders normally protect themselves is by negotiating a security package that ensures that repayment of the loans has priority over other claimants to the projects' cash flow, also in case of default or failure of the project. This is normally structured through various mechanisms including establishment of offshore revenue accounts into which the proceeds are deposited and to which the BOT lenders have priority, assignment of certain contracts to trustees who hold them on behalf of the lenders, and by establishing the right of the lenders to take over the project in case of serious default by the project company. Putting together a package in which the lenders will have confidence can be a difficult task in particular in those States without a highly developed capital and securities market.

42. Because of the non-recourse nature of the financing, the financiers and the project company have to find ways in which to handle other attendant risks, principal among them being the country risk (political risk) and currency risk (arising mainly from inflation and currency depreciation). Since these are beyond the influence of the project company or the lenders, one way in which they will attempt to mitigate some of these risks is by engaging export credit agencies to support part of the financing by guaranteeing payments for exports involved in implementing the project. Multilateral development agencies such as the World Bank and regional development banks have been involved in providing investment risk coverage, for example, through the World Bank's Multilateral Investment Guarantee Agency or similar entities. Involvement of multilateral institutions may also increase the confidence of potential lenders.

43. Some of the risks in a BOT project are similar to those in typical construction projects. For example, for the construction phase, the construction-completion risk is normally covered by a firm-date, turnkey construction contract between the project company and a contractor, which contract is typically supported by performance guarantees. Furthermore, the insurance industry provides cover for some of the more common risks (for example, third-party liability). In some of the developed insurance markets, cover may also be provided for some of the BOT-peculiar risks such as the risk of cash-flow shortfalls.

44. Notwithstanding the above-mentioned financial risk management techniques, a number of practical factors may make negotiations on risk management for BOT projects fairly complicated. Among these are that all the main parties have an interest in the manner in which the various risks are allocated and therefore will want to be involved in all the negotiations. In many instances, this is further complicated by the lack of experience in negotiating with multiple parties on these aspects of BOT projects. This may lead to the parties holding unrealistic positions regarding risk allocation, with the private sector, and in particular the lenders, aiming to reduce their risk exposure to very low levels, while the government aims to transfer all the risk to the

private sector.

45. Beyond the contracts that form part of the financial package, there are various other contracts in which the government, the lenders and the project company, being the three main parties, all have an interest. An example of this is the operating and maintenance contract. In some instances, the project company will enter into a contract with an independent operator to manage the operational phase of the project. But, even though the parties to the contract will be the project company and the operator, the lenders will want to be satisfied with the terms of the contract with a view to ensuring that the project is managed on an economically viable basis with adequate returns. The government will also have to ensure that its interests are adequately addressed in the contract with regard, for example, to matters such as the transfer of technology and good technical maintenance of the facility to guarantee that the facility is transferred in a good technical condition at the conclusion of the concession period. The interest of these other parties in a contract to which they may not directly be party can further complicate the contract negotiation process.

46. It would seem that the predominant problems that arise in BOT contracting are not related to the uniqueness of the individual component contracts as such, since most of such types of contracts have been utilized in the implementation of typical non-BOT projects. Guidance on the contractual issues that should be considered in the context of such traditional projects can, for example, be found in the UNCITRAL Legal Guide on Drawing up Contracts for the Construction of Industrial Works. It is the BOT context, however, in which a large number of interrelated contracts form a comprehensive contractual package, that gives rise to practical problems in the process of putting the contracts together. The timing, priority and manner in which the negotiations are conducted has therefore to be very well managed if the process is to be concluded in a timely and successful fashion.

III. CONCLUSION

47. From the above discussion, it may be concluded that governments and other contracting parties involved in carrying out BOT projects could benefit from assistance as to how to deal with some of the legal problems that might hinder proper and economical implementation of projects. The Commission may therefore wish to consider taking up work on BOT projects in particular as regards the legal infrastructure, the means of procurement and contracting. One form of such work could be the preparation of guidelines to assist States in establishing a legal framework that is conducive to the implementation of BOT projects, including guidance on the means of carrying out procurement for BOT in an economic and efficient manner. Another additional form of work, relating to contracting questions would be initiated by a study by the secretariat on the problems encountered in contracting for BOT, which study would include consideration of the means by which the Commission could carry out work in this respect.

48. With regard to guidelines for creation of an enabling legal infrastructure, this could address the types of general business, investment and commercial legislation that would provide a sound legal basis for carrying out BOT projects, together with model legislative provisions that could be used by States wishing to prepare specific legislation to govern the implementation of such projects. Model legislative provisions for BOT-specific legislation could deal with such issues as the legal basis for the granting of the concession, the extent of possible government support, the

regulatory framework for the management and operation of BOT projects, and possible incentives that the government may wish to grant.

49. As to procurement, the work could include guidance to governments on means of carrying out procurement in a manner that best promotes competition and transparency and avoids negotiations conducted in a manner that may cause loss of confidence in the procurement process. This could include guidance on preparation of solicitation documents, preparation of criteria for evaluation and the means of carrying out the evaluation in different circumstances. Means by which such guidance could be provided may include preparation of model procurement regulations or of model bid solicitation documents for BOT. This could also include guidance on how to deal with unsolicited tenders or proposals in a manner that balances the interests of the proponent of such tenders or proposals with those of the government to inject competition in the process.

50. With regard to contracting, it might be more useful, at this stage, for the Secretariat to continue to monitor and study developments on contracting for BOT with a view to considering how the Commission could carry out work in this area. This could possibly include preparation of a supplement on BOT contracting to the UNCITRAL Legal Guide on Drawing up International Contracts for the Construction of Industrial Works, in which would be discussed the mechanisms for BOT contracting, including a discussion on how the provisions in the principal contracts may be structured in the BOT context.

51. It is envisaged that, in the three areas of possible work referred to, the Commission's work would be tailored so as not to duplicate work already carried out by UNIDO on BOT projects. For example, in the UNIDO Guidelines, issues regarding the legislative framework are discussed in a chapter on government support for BOT project implementation. Although that chapter discusses the main features of such legislation and the problems that may arise due to the lack of a proper legislative framework, it remains to develop a comprehensive legislative guide as to what the different aspects of the legal framework should cover and, in particular, possible model provisions that may be included in BOT-specific legislation. The Guidelines also set out some of the problems that are encountered in the area of procurement. In this regard, as proposed in the present note, States would further benefit from practical guidance on how to avoid some of the problems discussed. As for contracting, the Guidelines describe the contents of some of the contracts with the main contracts, such as the project agreement, being given more detailed treatment. In this aspect also, States might benefit from more comprehensive guidance on the mechanics of BOT contracting and on the types of provisions that are key to arriving at a balanced contractual package.